

**DEPARTMENT OF STATE REVENUE
LETTER OF FINDINGS NUMBER: 97-0391 ITC
Gross and Adjusted Gross Income Tax
For Tax Periods: 1993 through 1995**

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ISSUES

I. Gross Income Tax — Credit Card Losses

Authority: IC 6-2.1-1-2; IC 6-2.1-4-2; IC 6-2.5-6-9

Taxpayer deducted credit card losses from its Indiana gross income. Taxpayer protests Audit's disallowance of these deductions.

II. Adjusted Gross Income Tax — Land Sales

Authority: IC 6-3-1-20

Taxpayer protests Audit's characterization of receipts from certain land sales as "business income."

STATEMENT OF FACTS

Taxpayer, incorporated and domiciled out-of-state, is a nationwide retailer. Taxpayer also buys land to build stores. Pursuant to Audit, income from taxpayer's "excess land sales" was reclassified from "non-business" to that of "business." Additionally, Audit disallowed taxpayer's deduction of credit card losses from its Indiana gross income. Taxpayer protests both decisions.

I. Gross Income Tax — Credit Card Losses**DISCUSSION**

Taxpayer, a general merchandise retailer, issued credit cards to its customers. (The credit cards were owned by taxpayer.) Credit card holders could use their cards only to purchase items sold in taxpayer's stores. Not all credit card holders, however, paid their bills. Taxpayer deducted, as bad debts, the uncollected credit card receipts on its federal income tax returns. Taxpayer also deducted the Indiana portion of these uncollected receipts from its Indiana gross income.

Audit disallowed these "bad debt" deductions from taxpayer's Indiana gross income. Audit determined – consistent with 45 IAC 1-1-51 and *Indiana Department of Revenue v. J.C. Penny Company, Inc.*, 412 N.E.2d 1246 (Ind. App., 1980) – that the credit cards, as intangibles, had a tax situs at taxpayer's out-of-state corporate headquarters. Audit reasoned that since the income (credit or service charges) associated with the intangible flows to the out-of-state situs, so too should the losses.

Taxpayer accounts for its income using the accrual method. Under this method, income is reported when the sale is made. Consistent with this method, taxpayer reports all receipts from Indiana store sales – including credit card sales – as Indiana gross income. See IC 6-2.1-1-2(f).

As to bad debts, IC 6-2.1-4-2 instructs:

Each taxable year, a taxpayer that reports his gross income on an accrual basis is entitled to deduct bad debts from his gross income in the same manner provided in IC 6-2.5-6-9.

IC 6-2.5-6-9 addresses how a taxpayer should account for uncollectible receivables when reporting its Indiana sales and use taxes. The relevant language reads:

(a) In determining the amount of state gross retail and use taxes which he must remit under section 7 of this chapter, a retail merchant shall deduct from his gross retail income from retail transactions made during a particular reporting period, an amount equal to his receivables which:

(2) resulted from retail transactions on which the retail merchant has previously paid the state gross retail or use tax liability to the department; and

(3) were written off as an uncollectible debt for federal tax purposes during the particular reporting period.

As noted, taxpayer uses the accrual method to account for its gross receipts. Taxpayer includes the receipts from its credit card sales in its Indiana gross income. The bad debts associated with the Indiana credit card sales are written off as uncollectible for federal income tax purposes. Since taxpayer has met the statutory requirements of IC 6-2.1-4-2 and IC 6-2.5-6-9, taxpayer is entitled to deduct the credit card "uncollectible" debts from its Indiana gross income.

FINDING

Taxpayer's protest is sustained

II. Adjusted Gross Income — Land Sales

DISCUSSION

Taxpayer purchased land for the purpose of building stores. Sometimes, taxpayer purchased more land than actually required. After all construction needs were met, taxpayer sold this "extra" land. As real estate transactions were not an "integral part" of taxpayer's business, taxpayer characterized the gain from these land sales as "non-business" income.

Audit disagrees. Audit reasoned that since taxpayer's "primary objective in purchasing the land...was to build retail stores rather than for investment purposes, [the]...acquisition was integral to the corporation's [taxpayer's] regular business activities."

In Indiana, business income is defined in the following manner:

The term "business income" means income arising from transactions and activity in the regular course of the taxpayer's trade or business and includes income from tangible and intangible property if the acquisition, management, and disposition of the property constitutes integral parts of the taxpayer's regular trade or business operations.

See IC 6-3-1-20.

Taxpayer buys land and builds stores in order to sell merchandise. The objective behind the land purchases is one of business – i.e., the building of retail stores. As such, the real estate transactions are an "integral part" of taxpayer's regular business operations. Conversely, taxpayer does not buy land and build stores for investment purposes – or for any other

discernable "non-business" purpose. The Department finds, therefore, that income earned from taxpayer's real estate sales should be classified as "business" income.

FINDING

Taxpayer's protest is denied.